Deciding How to Structure Your Business

When entrepreneurs, whether they are farmers, retailers, service providers, high-tech inventors, or others, determine to start or reorganize a business, they should investigate common options for structuring a business and choose one as the way to organize their enterprise. In general, they should pick the simplest form of organization possible, but one that meets their needs.

Choosing a form of business organization will depend on the goals and objectives of the owners. Many factors must be evaluated, including tax consequences, costs of formation, complexity, limitations on liability, needs of outside investors, estate planning and transition issues, and other goals of the owners.

In many situations the form of business organization may be dictated by the investors who are financing the business. Investors and lenders generally require use of a form of ownership that they believe will best protect their investment or security. Tax considerations must be taken into account but should not necessarily override other aspects. Estate planning issues and intra-family issues also will be important. If passive investors are involved, choosing a business form that limits their liability may be very important. Startup costs, ongoing maintenance costs, and costs associated with taxes are further considerations. Lastly, the willingness and ability of the owners to meet the formal requirements of whichever model is chosen are critical factors. It is futile to adopt a form of business organization if a court is going to set it aside because the owners failed to observe formalities.

Here is an overview of the most commonly used business-organization models—sole proprietorship, partnership, limited liability company, and corporation. Some other business models, such as trusts and estates, are not described here. Statutory limitations on the time that an estate may remain open prevent the use of an estate as a realistic choice for long-term operation of a business. Trusts, except for living trusts, usually function as passive owners in the business models described here. Revocable living trusts, when used to operate businesses directly, usually do not operate much differently than a sole proprietorship.

Sole Proprietorship

A sole proprietorship is the simplest form of business organization: One person owns all of the assets and is responsible for all of the debts. The business income is reported on the owner's federal tax return, Form 1040, Schedule C, C-EZ, or F. Many farms and independent businesses, such as restaurants, are operated as sole proprietorships.

Partnership

A partnership is an association of two or more persons established to conduct a business for profit. The relationship is consensual and usually bound by a legal contract that defines the partnership agreement. A partnership is treated as an entity for litigation and bankruptcy proceedings and may hold title to property. North Carolina has adopted the Uniform Partnership Act (UPA). Under the UPA, partners have equal management authority and share equally in profits and losses. The partners also have an equal obligation to contribute time, energy, and skill to the partnership business without compensation. Each partner has unlimited personal liability to the partnership's creditors, and all partners are liable for wrongful acts and breaches of trust by any partner. The UPA provides these default provisions in the absence of a partnership agreement to the contrary. Most provisions of the UPA can be

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